



Robert W. Wood
THE TAX LAWYER

TAXES 11/05/2018

Need A Tax Opinion? Here's Why You Might Want One For IRS

I write tax opinions, so I am biased about their value. Yet it surprises me how many people pay for tax opinions without thinking about what they are getting. Conversely, many don't get a tax opinion despite the need. If you wait until you are audited, it is too late. What exactly is a tax opinion? Distinguish between tax opinions about your own situation from tax opinions attached to investment programs. The best type of tax opinion is customized. It is formal written advice about your own tax circumstance, whatever they are.

You might have settled some litigation and received money, or paid big legal fees. You might have moved states, liquidated a business, sold or exchanged a stockpile of Bitcoin, or had an involuntary conversion or casualty loss. You might have received a legal settlement you hope is tax free because of physical injuries or sickness. You might be claiming that your stock sale proceeds are tax exempt as qualified small business stock. Whatever your situation, you want formal tax advice about the strengths and weaknesses of your position before you file your return and spend your money.

Tax opinions are usually thorough, discussing your facts and numbers, and the legal authorities. But when it comes to the bottom line conclusion, tax opinions generally conform to one of the following choices:

- *Not frivolous* = There's a 10% to 20% chance your argument will prevail.
- *Reasonable Basis* = There's a roughly one in three chance you'll win.
- *Substantial Authority* = There are cases both ways, but there's probably about a 40% chance you'll win.
- *More Likely Than Not* = The odds are better than 50% that you'll win.

- *Should* = It's about 60% likely that you'll win.
- *Will* = Your tax treatment is nearly assured.

Under IRS standards, the tax practitioner must *assume* there will be an audit. That way, the opinion's conclusion is not based on audit lottery. In reality, of course, audits are rare. One common question is the extent to which an opinion will get you out of penalties if the IRS disagrees with your treatment. In general, the higher the standard of opinion, the more it can help with penalties. However, even a lower level opinion helps. Even an opinion that you have a reasonable basis for your tax position can be enough to protect you if you disclose your position on your return.

Of course, just penalty protection isn't enough. You don't want to end up paying all of the tax and all of the interest, even if there are no penalties. What you *really* want is to have your tax position upheld. An opinion can help. In fact, an opinion can help put you in the best possible light on both the facts and the law. Although customized tax opinions are arguably the best kind, there is another type of tax opinion. Some tax opinions are marketed in connection with investment offerings.

Example: Your broker pitches you to buy an interest in an LLC owning railroad cars that will carry special food products. You get a prospectus showing you'll get depreciation and tax credit benefits worth five times your investment in the first 12 months. You can't sell for three years, but who needs sales proceeds when you're getting tax benefits like that! A tax opinion included with the prospectus says it is "more likely than not" you'll get your tax benefits. You may have had no contact with the law or accounting firm rendering the opinion.

You probably don't think of them as looking out for your interests, as they are representing the promoter or sponsor of the investment program. Still, it's clear you're supposed to be impressed by the opinion. You may get your own tax adviser to formally or informally opine on it too. Be careful with tax opinions of this sort. Sometimes, these investments go bad. The IRS may deny the tax benefits, and there may be litigation. One type of litigation is with the IRS. Another is between investors and promoters if the investment goes under or tax benefits are denied.

To return to the customized type of tax opinion, try to plan ahead and get some tax advice before you sign documents or make major decisions that will impact your taxes. Often, that kind of tax advice can precede a formal tax opinion naturally. That way, the tax adviser is part of the process and can help shape the tax opinion and make it stronger. And once the tax opinion is written and your tax returns are filed, you have a ready source of authority if the IRS comes knocking. If they do, don't hand the opinion to the IRS.

Instead, use it as a ready source to cut and paste into targeted responses to the IRS. Having all that work done in advance can make a world of difference.

This is not legal advice. For tax alerts or tax advice, email me at Wood@WoodLLP.com.